



STATE BOARD OF LAND COMMISSIONERS

Dirk Kempthorne, Governor and President of the Board
Ben Ysursa, Secretary of State
Lawrence G. Wasden, Attorney General
Keith L. Johnson, State Controller
Marilyn Howard, Superintendent of Public Instruction

Winston A Wiggins, Secretary to the Board

**Final Minutes
Regular Land Board Meeting
December 8, 2003**

The regular meeting of the Idaho State Board of Land Commissioners was held on Monday, December 8, 2003 in Boise, Idaho. The meeting began at 9:04 a.m. The Honorable Dirk Kempthorne presided. The following members were present:

Honorable Secretary of State Ben Ysursa
Honorable Attorney General Lawrence G. Wasden
Honorable State Controller Keith L. Johnson

Secretary to the Board Winston A Wiggins

Superintendent of Public Instruction Marilyn Howard participated in the meeting by conference phone.

• **CONSENT AGENDA**

Director Wiggins provided background information on the Consent Agenda items.

A motion was made by Secretary of State Ysursa to approve the Consent Agenda in its entirety. Attorney General Wasden seconded the motion. The motion carried on a vote of 5-0.

1. Director's Report – *approved*

- A. Interest Rate on Department Transactions – November 2003
- B. Bureau of Surface and Resource Management, Minerals Section, Official Transactions – October 2003
- C. Bureau of Real Estate, Land Sale Section, Official Transactions – October 2003
- D. Bureau of Real Estate, Easement Section, Official Transactions – October 2003
- E. Bureau of Surface and Resource Management, Range Management and Surface Leasing Section, Official Transactions – October 2003
- F. Timber Sale Official Transactions – November 2003
- G. Timber Sale Activity Report
- H. Legal Matter Summary

2. **Final Approval for IDL/IDFG Land Exchange** – *Staffed by Perry Whittaker, Chief, Bureau of Real Estate* – **approved**

DEPARTMENT RECOMMENDATION: Direct the Department to complete the final exchange as proposed.

BOARD ACTION: Approved.

3. **Minutes** – **approved**

A. Regular Land Board Meeting – November 12, 2003

• **REGULAR SESSION**

4. **Contract Extensions (Timber)** – *Presented by Ron Litz, Assistant Director, Forestry & Fire*

A. **TS-4-3042 Marsh Cemetery, Three Rivers Timber, Inc.**

DEPARTMENT RECOMMENDATION: That no further extensions be granted; that the State enter a forfeiture of the contract and take action to recover damages from the Purchaser or surety or sureties; terminate the Purchaser's right to go upon the sale area for the purpose of cutting and/or transporting any forest products; that the Purchaser be precluded from bidding on further State sales until they are in compliance with the minimum harvest schedule, as outlined in the June 13, 2003 Minimum Harvest Schedule.

BOARD ACTION: See Below.

B. **TS-4-3100 West Benton Butte, Three Rivers Timber, Inc.**

DEPARTMENT RECOMMENDATION: That a fifth extension be granted with the stipulation that it is the final extension for this sale. If the Purchaser does not fully complete this sale by November 21, 2004, the State will consider the Purchaser in breach of contract and will initiate breach proceedings.

DISCUSSION *(for items 4A and 4B above):* Secretary of State Ysursa asked if Mr. Mulligan signed off on the June 13 plan. Assistant Director Litz stated he did not. In fact, Mr. Mulligan provided in writing that he could not meet the plan. Secretary of State Ysursa suggested it might be a better policy in the future to have the purchaser sign the plan. Assistant Director Litz stated that could easily be done. Secretary of State Ysursa asked how many contract extensions have been declared in default and breached in the past. Assistant Director Litz stated to his knowledge none.

Controller Johnson asked if letters sent to Mr. Mulligan regarding final extensions were authorized by the Board, Board policy or did the correspondence reflect Department position. Assistant Director Litz stated there were two letters. The ones the Board acted upon in July were Board actions for Lower Wilson and Waha because those were the fifth and sixth extensions. The other ones that were not a fifth extension were handled by the Department along with Board staff. Controller Johnson asked if the statute allows the Board to grant extensions on the two contracts under consideration, Marsh Cemetery and West Benton Butte. Assistant Director Litz stated it does. Controller Johnson asked what the impact of following the recommendations of the Department would be to Mr. Mulligan. Assistant Director Litz deferred to Mr. Mulligan.

Mr. Mulligan stated when the original schedule was discussed he had a burnt salvage Forest Service timber sale under contract. In January and February he had a priority of having to complete that timber sale before the timber further deteriorated. Due to that fact, he did not have the ability to work on the state timber sale portfolio during those two months. Mr. Mulligan explained that in North Idaho he is not able to log until about mid-May. He did, however, look at his cycle to determine the sales he could operate on starting in mid-May. He completed the Waha timber sale, the Tommy Taha pulp sale and the Wilson Creek pulp sale. On Marsh there was not enough time in the year from May 15 to the first of the year to get all of it done. It was his plan to finish in January and February 2004, which is where he stands now. He has saws and a contractor ready and that sale is partially completed. Mr. Mulligan stated it was his intent to complete all of the sales in his portfolio. He stated it is a matter of how those contracts are scheduled. However, Mr. Mulligan stated he is under the same problem that the endowment fund has experienced. Three years of poor lumber markets and Canadian lumber imports took his flexibility away. Three Rivers Timber felt that the extension policy and timber sale contract was specifically designed to provide that kind of flexibility in the State of Idaho so if a company came before the Board and asked for an extension, and shows that the sales could be completed, that the provision would cover the situation.

Controller Johnson asked what the impact would be on the operation of Three Rivers Timber if the Department recommendation was approved. Mr. Mulligan stated Three Rivers is paying a lot of interest on that timber sale and they are working to complete the sale as quickly as possible. He believes the best result to the endowment is to approve the extension. From a business standpoint, Mr. Mulligan stated he does not want to lose the deposit. The deposit pays for a good share of the stumpage that is left. If the extension is not granted, Mr. Mulligan stated he would have to replace his bond with cash to make good for that and to not expose his bonding company. He would lose his bid deposit and, from that standpoint, the State would have to go through re-advertising the remaining volume and probably would not be able to re-advertise until next June or July. There would also be a delay in the income to the endowment. Controller Johnson commented that according to the briefing packet half of the timber has been harvested already. Mr. Mulligan agreed.

Governor Kempthorne asked Mr. Mulligan when he would be able to complete the remainder of the sale. Weather permitting, and if he can not get all of the hauling done before breakup, Mr. Mulligan stated he would at least be able to get the logs in deck, unless he experienced soft or poor weather. He may be able to get the brush piling and other contract work done before breakup, but most certainly before the weather improved after spring he would come back and finish the contract requirements. Governor Kempthorne asked for a definition of "breakup." Mr. Mulligan stated "breakup" is over around May 15th so it would be somewhere around the first of June to the first of July to do the last brush piling and road maintenance work or to haul the last logs off, if wood hauling was not completed. Governor Kempthorne asked if Mr. Mulligan believed that by July 1 he could have the last of the logs on the remaining parcel removed. Mr. Mulligan stated he believes so.

Governor Kempthorne asked how many employees are under this contract. Mr. Mulligan stated approximately 200 families depend on the Three Rivers operation. He also stated that when he purchased the operation from Weyerhaeuser eight years ago, the mill was scheduled for shutdown and auctioning of equipment. No other party expressed interest in buying it. For the last eight years, Three Rivers Timber has provided stability to the community and has been a consistent bidder for state timber in the region. Governor Kempthorne asked if Mr. Mulligan was stating he could have the last of the trees removed by July 1st. Mr. Mulligan stated yes.

Governor Kempthorne asked if the Board were to not extend the sale, but instead re-bid, how soon could that be done. Assistant Director Litz stated the sale could be re-advertised and offered for sale somewhere mid-March or the first of April. The Department would end up putting

on a two-year contract period for the new sale so there would be no guarantee that anybody could be in and complete the sale by July 1st. Governor Kempthorne commented that Mr. Mulligan received the Department letter stating this was the final extension. He did not sign an agreement to that effect. Governor Kempthorne asked if Mr. Mulligan was willing to sign a letter now that would stipulate a date certain that he would either have the harvest completed or he would surrender the contract. Mr. Mulligan stated on that particular sale he would. Governor Kempthorne stated another aspect is the impact to the endowment. Secretary of State Ysursa added that part of the problem is the contract contains high-priced timber at a higher interest rate. If the contract was re-bid, there is no way the same price would be obtained. Assistant Director Litz agreed.

Governor Kempthorne suggested that this agenda item be deferred to allow a written instrument to be developed that both parties would sign. This instrument would put a date certain that the remainder of the harvest would occur. If it does not, there are no further extensions, and Three Rivers would then surrender the remaining timber on the contract. Mr. Mulligan agreed stating he is willing to do that. Director Wiggins asked for clarification. He asked if this discussion is restricted to the Marsh sale because the program outlined for Three Rivers has a number of extensions stacked up. Director Wiggins believes the smart thing to do would be to sit down with Three Rivers to develop a schedule and conditions for the whole portfolio. Another discussion point is a longer timeframe is probably appropriate rather than expecting the sale to be totally completed by July 1st.

Based on the length of time needed for re-bid, and the fact that it would be for a two-year period, Governor Kempthorne stated that anything done this year would be a benefit to the endowment. Director Wiggins stated the very best scenario is for Mr. Mulligan to complete all of the sales. There is a significant difference to the endowments as far as the timing of those sales. There is no disagreement that the very best thing is that the sales be logged and the sooner the better.

Governor Kempthorne stated he understands the point about not handling the sales in a piecemeal fashion. He asked how many contracts are left. Mr. Mulligan responded seven contracts are under extensions. Governor Kempthorne asked Mr. Mulligan if what he is saying today is that he can move on the Marsh contract and have it done by July 1. Mr. Mulligan stated that is correct.

Governor Kempthorne commented Marsh could be brought back to the Board next month and then the remainder of the contracts could be brought back to the Board in two months. Director Wiggins stated, based on what Mr. Mulligan said today, the Board could grant the Department authority on Marsh to extend, conditioned on a date certain commitment from Mr. Mulligan. Governor Kempthorne stated if there is a commitment, it needs to be a signed commitment. Mr. Mulligan concurred with Director Wiggins.

Superintendent Howard commented it worries her that the Board is not addressing the issue of Ladd's Creek and China Gulch. Those sales were also let in 1997 and have a large amount of interest due. Superintendent Howard is concerned about getting a commitment from Mr. Mulligan to the harvest those sales. Her concern is also how long those sales would be extended and is there a way to avoid having Mr. Mulligan terminate those sales. She believes at some point the Board needs to create conditions that would make it less likely for Mr. Mulligan to walk away from the sales where the dollar amounts are large. Mr. Mulligan responded that the markets have improved in 2003 enough to allow Three Rivers to do more operating. Three Rivers has a major capital program for its plant which will decrease operating costs and increase output. It also gives Mr. Mulligan more flexibility starting next year to attack the portfolio more aggressively. It is Mr. Mulligan's intent to execute every timber sale in his portfolio. Three Rivers has never defaulted, and they do not plan to default. Mr. Mulligan stated he does not plan to use the buyout option within the contract at this time. Superintendent Howard stated she appreciates that. However,

she does not know when Ladd's Creek and China Gulch would come up for discussion. Secretary of State Ysursa stated in the June 13th letter the Department recommended Ladd's Creek for a possible fourth extension and a fifth extension expiring April 18, 2005; China Gulch with a possible extension that would expire June 27, 2005. Assistant Director Litz agreed.

Secretary of State Ysursa commented part of his point is to have the purchaser sign on the dotted line that what the Department puts out, and what is agreed to, is it. Not at the whim of the markets or anything else. The Department has been very flexible. He recommended agreement on a schedule with the purchaser signing with the Department.

Superintendent Howard commented one of the recommendations is that purchaser could be precluded from bidding on future state sales unless they are in compliance. No one wants to put rural workers out of work. While those economies are needed, the Board also needs to have assurance that it is not going to hold onto something for a very long time, and then find that it is, in essence, in default.

Governor Kempthorne asked Mr. Mulligan if he is amenable to that approach. Mr. Mulligan stated he is under contract so he has to. The only thing is the schedule has to be realistic. He stated he did everything he could, but he could not meet the Department's schedule in the specified timeframe.

Governor Kempthorne stated Secretary of State Ysursa has a very good suggestion, and that is the Department and Three Rivers need to sit down and come up with an agreed upon realistic schedule. Both parties would sign that they agree, and then we would all know the predictability of it. It would seem the situation regarding Marsh can be worked out. And, subject to Board approval, the Board will give the Department authority to proceed with Marsh Cemetery. But then work needs to be done on the remainder of the contracts.

Attorney General Wasden added in prior meetings of this Board, he made either a motion or a request to the Department that they include the finality language in the letters to Three Rivers Timber. Attorney General Wasden stated he wanted to make sure that everyone understood that he made that request, and that it was not the Department acting alone. Attorney General Wasden feels the Board has to get serious about getting these contracts harvested either by Three Rivers Timber or by somebody else because there is a deprivation to other participants in the lumber market. That deprivation is access to these sales, and that access is being delayed in terms of harvesting this timber and getting money into the endowments. He believes the Board and the Department have to figure out a plan to either get this done or move on. The process of continually granting extensions can not continue.

BOARD ACTION *(for items 4.A and 4.B above):* A motion was made by Controller Johnson that:

- The Department grant extensions to the Marsh Cemetery and West Benton Butte timber sale contracts contingent on a signed agreement by Three Rivers Timber Company to complete the sales by a date certain or Three Rivers Timber Company will relinquish the contracts.
- The Department and Three Rivers Timber Company work together to develop a satisfactory harvest schedule on all remaining Three Rivers contracts. The harvest schedule will be confirmed in writing. The basis for the discussions will be the June 13, 2003 letter from Ron Litz to Three Rivers Timber Company except where the schedule included in that letter is, in the opinion of both parties, extraordinarily out of line.

The motion was seconded by Secretary of State Ysursa. The motion carried by a vote of 5-0.

5. **Contract Extensions – Timber, Salvage and Direct Sales** – *Presented by Ron Litz, Assistant Director, Forestry & Fire – WITHDRAWN*
6. **Grazing Lease G-4597, Lacey Meadows Allotment** – *Presented by Winston Wiggins, Director, Idaho Department of Lands*

DEPARTMENT RECOMMENDATION: That the Department award a ten-year grazing lease for the Lacey Meadows allotment to WWP under the following conditions: written confirmation from WWP of a management plan, acceptable to the State, by January 31, 2004. The plan must provide: a commitment to physically remove trespass livestock, defined as cattle, regardless of ownership, being in places where they are not supposed to be, from the allotment; a commitment to a weed control program that, in the opinion of the Department, is equal to or exceeds the program executed by LMGA; a commitment to conduct monitoring, approved by IDL; payment to LMGA for the appraised value of improvements approved by IDL; a commitment to maintain all improvements in a condition acceptable to the State. If this written confirmation is not in place by January 31, 2004, award a ten-year grazing lease to LMGA conditioned on confirmation of a management plan acceptable to the State by April 1, 2004; when the lease is awarded, refund the conflict premium bid to the non-successful party.

DISCUSSION: Secretary of State Ysursa asked if the Land Board can augment the record and consider the latest grazing season with the proviso that WWP would be afforded an opportunity to rebut any of that evidence and add to the record. Attorney General Wasden responded there are a couple of things that are of very great significance here. Idaho Code Section 58-122 sets out this procedure. The last sentence of that code section provides that the Director, as soon as convenient after such hearings, must present a full transcript of the proceedings to the State Board of Land Commissioners, who shall render a decision in accordance therewith. That language says that it is based upon the record, whatever that record is, and we have that record now. One of the things that our whole system is based upon is due process, and due process requires notice and an opportunity for a fair hearing. So to include something post application for this would mean that both parties would need at the very minimum an opportunity to address whatever that information was. Otherwise it is not a fair opportunity. It is not meaningful to address those issues if something is stuck in when one party or another does not have an opportunity to address it. There are certain due process risks inherent in including things at this stage that were not included in that transcript. At a minimum to include that would have to provide both parties an opportunity to fully and fairly address whatever information was supplementing that record.

Secretary of State Ysursa commented that what bothers him as a Board member is to have blinders on what happened in 2003 if, in fact, trespass is the key issue. Attorney General Wasden commented that a temporary permit was granted to Lacey Meadows for the current grazing season. It was not an extension of the prior lease. Governor Kempthorne observed that none of the performance during that year was considered by the Director and the Hearing Officer. Director Wiggins clarified that this is actually the second temporary permit issued. Lacey Meadows Grazing Association operated under terms of a temporary permit for the 2001, 2002 and 2003 seasons. Performance reports for the 2001 and 2002 seasons were a part of the record. The performance report for the 2003 season was not.

Deputy Attorney General Clive Strong advised that it is within the Board's discretion to have matters that were not considered at the hearing considered by the Hearing Officer. The procedure used was Idaho Code Section 58-122, which the Board directed the Director of the Department of Lands to conduct a hearing for the purpose of making a recommendation to this Board on how to proceed with the lease. Under that procedure it does provide that the hearing will be conducted on the record, and the record will be submitted to the Board for consideration. If the Board were to choose to have matters that were not a part of that record considered, the appropriate course of proceeding would be

to remand it back to the Director with directions to provide the parties an opportunity to brief the issue of considering these reports that were prepared this summer.

Governor Kempthorne restated that the recommendation from the Attorney General's office is to remand it to the Director to include the latest information from this last grazing period and to give ample opportunity for Western Watersheds Project to be able to rebut or provide any information. Deputy Attorney General Strong stated the recommendation being made is if the Board chooses to have that information considered, that would be the appropriate procedure to use. Governor Kempthorne asked if that is the recommendation of the Attorney General's office. Attorney General Wasden responded that is a difficult question. Board members have to be satisfied with the record that is there. If the Board chooses to include the current temporary permit reports, then he concurs that it must be sent back to the Department's Director for his consideration.

Controller Johnson added that he is not comfortable with the current record as it exists. He is not sure he would come to the same conclusion. He agrees that the three key issues are weed control, improvements and trespass. On weed control, both parties are weak. It is difficult to determine who has the better plan. On improvements, the language was that nothing indicated that the efforts of the Grazing Association to maintain their fences was less than satisfactory. It sounds like they had a good record maintaining those improvements, but that Western Watersheds was vague. Controller Johnson stated he would score that one to the Grazing Association. That leaves the key issue of trespass. When the Board met last spring to grant the temporary permit, it was with the provision and responsibility that Lacey would work harder to control trespass issues. Controller Johnson stated he would be interested to see how well Lacey did this year, and he would encourage the Board to go back and take a look at that, and to certainly give Western Watersheds an opportunity to rebut the information.

Dr. Howard stated she is concerned about not just today, but also about the long-term commitment of either party to the conditions. She believes there is a tendency sometimes for the goal to be to get the ten-year lease, and then once that is in place to decide just how carefully to adhere to the conditions. One of the components put forward in the plan is for a range rider. This is a commitment to physically remove trespass livestock. It is having someone on the ground in the area to do the kind of monitoring and maintenance necessary. Dr. Howard's concern is twofold. One is that on a long-term lease situation either party could decide to ease up on those conditions. The second part is the lack of information on the past year. Was the performance of Lacey Meadows during that time directly related to convincing the Land Board that they were a changed group? In other words, how does the Board make sure in the long term that it continues to have the same kind of commitment to this lease, and its control, without adding more cost to the Department of Lands? As has already been pointed out, this is one of those leases which actually may result in a net loss to the endowment. Director Wiggins responded that the way the Department ensures compliance would be the same with either party. The Department has to expend resources on site to ensure that the terms of the lease are met.

Superintendent Howard asked what evidence the Department would accept that monitoring is occurring. She is trying to find ways that would be less dependent on the Department incurring increased cost and more dependent on the agency or group actually following through and reporting those actions in some measurable or valid way. Director Wiggins responded the Department's expectation would be that should the lease go to Western Watersheds, they would provide a contact so that when trespass occurred, that contact would be notified, and the cattle would be removed. But the expectation would also be that WWP have someone onsite who would see the trespass and act independently to remove it, which is much of what is expected from Lacey Meadows. No matter what program you have, and no matter what expectations you put on a lessee, it is still going to require monitoring by the Department.

Deputy Attorney General Strong stated the question posed by the Superintendent is the very issue for why the Board would need to remand, if it wants to consider this evidence. The reason to remand back to the Director for consideration is it is the question of what weight or credibility is given to the various positions about that performance. That information is currently not before the Board for consideration, and so the real issue is if the Board wants to have that considered, then it is most appropriate to have it remanded back and then to allow the parties to make their arguments as to the relevancy of that evidence, and the weight that should be accorded to it, and then bring it back to the Board.

Governor Kempthorne restated that the Board granted a permit for 2003. The results of that season are not part of the record. They were not considered by the Director. They were not reviewed by the Hearing Officer. So that is the issue before the Board today – whether the Board should remand this and ask them to now evaluate what were the lease inspection reports for the 2003 period where we had granted a permit for the operation to continue. And if, in fact, the Board does remand, then it must assure that Western Watershed has opportunity for any rebuttal and input.

Governor Kempthorne acknowledged the presence of Mr. Schroder in the audience. He stated, however, that he was reluctant to invite Mr. Schroder forward because of the nature of the Hearing Officer record, and a determination that is to be contemplated by the Board as to whether to continue the record.

Superintendent Howard asked when the current temporary lease terminates what kind of timeline is the Board looking at if a motion is to be made to remand it to include latest information. Director Wiggins responded it is his understanding that the current permit expires at the end of December 2003.

Governor Kempthorne asked when active management would be necessary. Director Wiggins responded June 1.

BOARD ACTION: A motion was made by Controller Johnson to remand this agenda item back to the Director to include for consideration all of the grazing lease inspection reports of the 2003 grazing season. After reviewing the reports, the Director will bring a final recommendation to the Board. The Director will ensure that all procedural due process requirements are adhered to. Secretary of State Ysursa seconded the motion. The motion carried on a vote of 5-0.

7. Joint Meeting with the Endowment Fund Investment Board – Presented by Matthew Haertzen, CFA, Manager of Investments, EFIB and Winston Wiggins, Director, IDL

DISCUSSION: Mr. Haertzen provided background information for the Board. Mr. Lou Henry, Deloitte and Touche, presented the Endowment Fund audit for fiscal year 2003. Mr. John Pickett, Dain Raucher, also provided comments.

A. Audit Report

Mr. Henry stated no instances of non-compliance with the laws and regulations and no material weakness in the internal control system were found. One reportable condition required revision in how the internal control operated within the Endowment Board management due primarily to changes in the system. An examination of management's assertions was conducted along with a review of the statutes and policies in place with the Endowment Board to measure whether rules are being followed. This review was conducted every year during the engagement of Deloitte and Touche. No exceptions were noted this year.

In the area of comments and recommendations, five comments were made.

- Manager of Investments should review and approve manual adjusting entries. It was requested that the Manager of Investments review any journal entries being made by the accountant to provide a second look. Due to the makeup of the staff, Mr. Haertzen was the only logical person to provide that check and balance.
- Implement accrual basis year-end closing procedures – 2003 was the first test of new 13th period capability. Most of the new money comes in from the Department and goes to the Endowment.
- Implement timely reconciliation process with the Department of Lands – incorporated in new data entry and reconciling process. Reconciliation should be initiated at the Department of Lands because the population of what flows through begins there.
- Verify completeness of year-end unsettled trades listing before posting to ledger. Another relatively minor item is dealing with year-end cutoff procedures and information provided by contracted services. The EFIB will need to follow up on unsettled trades that are in process at year-end to make sure they get the correct information.
- Record investment purchases and sales separately rather than net. The last item is to record investment purchases and sales gross rather than net, which is a GASBY 34 requirement.

The audit went relatively smoothly with good cooperation from the Endowment staff. This is Mr. Henry's last report. Another firm has been selected for the next audit.

Governor Kempthorne praised Mr. Henry for his outstanding service. Governor Kempthorne stated his intent has been to facilitate communication and transparency. He asked Mr. Henry if he had any suggestions or insights for the Board. Mr. Henry stated the interaction is a good example of where improvement is helping the reconciliation process between Lands and the Endowment. Working across department lines, and working with different groups within government, has improved the understanding from the various participants.

Controller Johnson also praised Mr. Henry and Deloitte and Touche for the great service they have provided the State of Idaho. In addition, Chairman Buffington expressed his appreciation for a job well done.

Mr. Haertzen commented that the EFIB is seriously considering the key findings from Deloitte and Touche. All issues have been addressed. Mr. Haertzen does not expect those items to be issues going forward.

At this point, Governor Kempthorne invited Jae Hallett, Balukoff Lindstrom & Company, P.A., to address the Board. Upon confirmation by the Endowment Fund Investment Board, Balukoff Lindstrom & Company will assume future audit responsibilities for the EFIB.

Mr. Hallett stated the EFIB has done an excellent job in terms of trying to immediately implement procedures designed to overcome problems. Balukoff intends to make sure parties involved receive accurate and timely information on a quarterly basis. Governor Kempthorne requested that any concerns or questions be shared with Mr. Haertzen and the respective boards whenever necessary.

B. Spending Policy

Mr. Haertzen presented information on the spending policy. Mr. Haertzen proposed cutting the spending policy from 7.5% to 4.5%. Governor Kempthorne asked if it might be better to go to the 4% now instead of 4.5%. Mr. Haertzen stated he believes the 4.5% payout can be sustained. However, the lower the percentage the more confident he becomes about actually meeting the payouts. Mr. John Pickett, Dain Rauscher, agreed. Dr. Miller, Endowment Fund Investment

Board member, also agreed commenting that the important thing to do is to look at the long term and not the short term.

Dr. Howard stated the cautionary pathway is to go with 4% from the standpoint that the schools have more assurance. The hardest part for school districts is when a number is projected and then that number does not follow through. Dr. Howard believes districts would want to go with the most reliable number from year to year.

Secretary of State Ysursa stated the Board should also be cognizant of the fact that timber circumstances can change. Director Wiggins agreed but added that it is speculative. We do not know where the market will go or what the prices will be, but it can certainly be higher when more timber is harvested at the same price. Dr. Howard stated she is a bit cautious regarding the increased timber harvest because trying to anticipate timber markets is difficult. She recognizes there are unknown terms and added costs for timber harvests along with projections for increased Land Board expenses associated with any new cutting.

Governor Kempthorne asked Director Wiggins to affirm when IDL made the recommendation to increase the annual timber harvest on state land, the motivation for that was for forest health. Director Wiggins stated that is correct. The Department's objective as fiduciaries is long-term return. We have a number of timber stands that are overstocked. If those stands are treated, they will have a better chance to grow faster, more vigorously and be less susceptible to insects, disease and fire. That, in turn, maintains the health and productivity of the site and that contributes to long-term revenue. That is the motivation. We did not consider the fact that timber revenues were down as we considered our proposal.

C. Earnings Reserve Level – Current Market Condition

Governor Kempthorne asked Mr. Haertzen for his view of the market going forward. Mr. Haertzen stated he is reasonably optimistic.

Governor Kempthorne commended Mr. Haertzen and the EFIB for their decisive action taken in the wake of the Strong mutual fund scandal. On that issue, Governor Kempthorne asked how we evaluate the ethical environment or the governance environment of fund managers to assure ourselves that we are not heading down that road. He asked if we do anything proactively to measure or to evaluate that risk. How do we know that the CEOs or CFOs are operating ethically within the rules? Mr. Haertzen stated the EFIB team spends a lot of time getting to know these people personally and trying to understand them and the way they are managing their business. We also take a look at other issues that might affect them. But it is a difficult area. Mr. Pickett agreed. It is something we look at especially in the mutual fund area. We look at every manager. We have learned that there is no audit system, no compliance to catch it, but once you see it, then, you react and that is what we did.

Governor Kempthorne stated Mr. Haertzen mentioned about the market improving and we are beginning to make up for what was lost. Currently there is a requirement that there is a four-year cycle that if the fund has developed a deficit then the general fund is to make up that difference to the schools. Now I believe that in fiscal year 05, because it was 01 that it first happened, that in 05 we would first encounter that four-year trigger. I would like to know if you believe it will be necessary for 05, or have we made up sufficient ground that it will not be. Also, how realistic is a four-year cycle because that was an arbitrary number chosen. Mr. Haertzen responded that the loss in fiscal year 01 was about \$46 million for public schools. If today was the last day of the fiscal year, we would just make up that amount when we allocate the gain and loss between earnings reserve – or the gain in earnings reserve and corpus – so there would not be a necessary loss makeup in that first fiscal year at this point. With that said, the second year was \$71 million so we are not anywhere near addressing the second year at this point. To the question of the four-year cycle, four years is too short a timeframe. Mr. Haertzen stated he would

like to see that extended out to about a ten-year timeframe with the idea of having a full market cycle within the timeframe before making up losses is considered. We need a longer term focus so we can manage our long-term investment assets.

BOARD ACTION: No action was taken on this agenda item.

- **INFORMATION AGENDA**

Director Wiggins briefed the Board on the Information Agenda items. No Land Board action is required on the Information Agenda.

8. WWP Reclassification Request (Spotted Frog/Sam Noble Springs) Grazing Lease G-6092

9. *State of Idaho v. Blaine County* – Update

- **EXECUTIVE SESSION – WITHDRAWN**

- A. To Consider Records that are Exempt from Disclosure [[Idaho Code § 67-2345\(1\)\(d\)](#)]
- B. To Consider and Advise Its Legal Representatives in Pending Litigation or Where There is a General Public Awareness of Probable Litigation [[Idaho Code § 67-2345\(1\)\(f\)](#)]
- C. To Consider Personnel Matters [[Idaho Code § 67-2345\(1\)\(b\)](#)]

There being no further business to come before the Board, the meeting adjourned at 11:45 a.m.

IDAHO STATE BOARD OF LAND COMMISSIONERS

/s/ Dirk Kempthorne

President, State Board of Land Commissioners and
Governor of the State of Idaho

/s/ Ben Ysursa

Ben Ysursa
Secretary of State

/s/ Winston A Wiggins

Winston A Wiggins
Director

<p>The above-listed final minutes were approved by the State Board of Land Commissioners at the February 10, 2004 regular Land Board meeting.</p>
